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IN THE

Supreme Court of the United States

OCTOBER TERM, 1934

No. 522

MANUFACTURERS' FINANCE COMPANY,
Petitioner,

vs.

FRANK M. McKEY, as Trustee in Bankruptcy of the Estate of GRIGSBY-GRUNOW COMPANY,
Respondent.

BRIEF OF PETITIONER

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BRIEF OF PETITIONER

Decisions Below.

The opinion of the Circuit Court of Appeals for the Seventh Circuit is reported in 72 Fed. (2) 471 (R. 93).

The memoranda opinion of the District Court has not been officially reported, but is printed in full in the record (R. 70).

Jurisdiction.

Certiorari was granted by this Honorable Court December 3, 1934.

STATEMENT OF THE CASE.

A bill of complaint in equity was filed in the United States District Court for the Northern District of Illinois, Eastern Division, on November 23, 1933, by one creditor with a claim sufficient to confer jurisdiction, against the Grigsby-Grunow Company (hereinafter termed company) an Illinois corporation (R. 2). The following day the company answered, admitting the averments of the bill and joining in the prayer thereof (R. 6) whereupon the District Court appointed the vice president of the company (R. 52) and counsel for respondent, as temporary receivers (R. 7) for all the property and assets of the company alleged to be worth $13,000,000 in excess of liabilities (R. 3, 65) with the usual powers of operating receivers (R. 7, 9) and they qualified the same day (R. 9). On December 5, 1933, by special order the receivers were continued as such and granted unrestricted powers to operate the business and properties of the company as a going concern (R. 19).

November 29, 1933, petitioner filed its intervening petition in the main proceeding (R. 13) alleging that it had fully performed a contract that it had entered into with the company, bearing date October 5, 1933 (R. 46), providing for the purchase from the company of such accounts receivable as might be acceptable to it and for the performance of certain services for which the company agreed to pay fixed compensation.* The making, execution and de-

*The contract provided for the sale of accounts receivable to petitioner by the company, for which petitioner agreed to pay the company 100 per cent of the actual net amounts thereof, of which 50 per cent was to be paid upon acceptance of such accounts by petitioner and the remaining 50 per cent, less any deductions and plus any overpayments by debtors, and less the compensation, was to be paid to the company immediately upon payment of the accounts to petitioner, with the proviso that such remainder need not be paid by petitioner so long as any account pur-

ivery of the contract by the company was approved by its Board of Directors (R. 65, 66).

Under said contract petitioner claimed to have purchased accounts receivable aggregating approximately one and one-half million dollars (R. 33, 34) and to have paid about $750,000 thereon (R. 33) and that when the receivers were appointed petitioner held accounts amounting to approximately $550,000 and had paid the company therefor about $265,000 (R. 13); petitioner further prayed that the court direct its receivers to deliver to petitioner all moneys collected by them on accounts theretofore assigned to petitioner until such time as it shall have received the amount due it, together with reasonable attorney's fees, costs and expenses (R. 16).

This intervening petition was necessitated by the refusal of the receivers to pay over any moneys collected on accounts purchased by petitioner until directed to do so by

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chased by petitioner from the company shall be in any manner affected by any breach or violation of any warranty of the company (R. 47). The company warranted there would be no appointment of receivers for the company (R. 48, 49).

The company was given the right to collect such accounts; such right to terminate in the event, among others, of a business failure of the company. Proceeds of collections were to be transmitted to petitioner in kind, each day as received (R. 47). If incurred, the company was to pay petitioner's attorney's fees, costs and expenses (R. 49). The rate of compensation was 83½ per cent of 1/30 of 1 per cent of the net face amount of accounts for each day from the date of purchase by, until paid to, petitioner (R. 48, 62). This compensation was at the rate of 20 per cent per annum (R. 63).

The services to be performed by petitioner consisted of: (1) to furnish by mail to the company credit information in hand about the customers of the company, upon request of the company (R. 47). (2) Have auditors give to the company the report of such examination therein provided for, with full information and advice as to the most desirable method of keeping the books, records and accounts of the company. (3) Pay for all accounting, postage and credit investigations of accounts purchased or offered for purchase, and upon request give financial and business advice. (4) Accept at par, less exchange, subject to payment, all remittances received through the company. (5) Obtain and have on hand at all times, sufficient funds to make prompt remittance to the company for all acceptable accounts within the limits agreed upon. (6) Supply all forms needed for assignment of accounts. (7) Place petitioner's credit and collection department at the disposal of the company and permit the company to submit any of its sales contracts with its customers to the general counsel of petitioner for advice and opinion as to form and legality thereof (R. 48).

the court (R. 43, Par. 13) and by the entry of an order on the petition of the receivers, *without notice to petitioner* to turn over and deliver to petitioner *on the same basis as prior to the filing of the bill of complaint* funds collected by the receivers on such assigned accounts (R. 63) and after all efforts to amicably adjust the controversy had failed (R. 63, 64). The receivers filed their answer (R. 17) virtually admitting the allegations of the petition and by way of a defense stated that they had expended time and money in dealing with debtors which "redounded to the benefit of petitioner"; that the contract involved merely a loan of money to the company and that they can see no justification for equitable charge against them upon balances owing as of the date of receivership of an interest rate thereupon in excess of the legal maximum rate permitted by the laws of the State of Illinois; that in the practice between the company and petitioner prior to receivership one-half of accounts collected was paid to petitioner, the accounts remaining substantially twice in face amount of net remaining advances.* That all collections upon such accounts made since the appointment of the receivers were placed in a special bank account (R. 19), the answer not denying full performance by petitioner and not denying various breaches of the contract by the company (R. 17). On the trial the receivers filed an amendment to the answer, alleging that the principal amount of the advances and interest at the contract rate to the date of the appointment of the receivers was paid to petitioner and the words "legal maximum rate" were changed to "7 per cent per annum" and denied that in equity petitioner is entitled to recover attorney's fees (R. 21).

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*This was erroneous. The stipulated facts are that when the company received payment from its customers it transmitted each payment in its original form to petitioner. Petitioner would endorse and deposit the remittance thus received and remit to the company the balance of the face value of the accounts not already advanced, that is, 50 per cent less any deductions and plus any overpayments by the respective debtors (R. 43, Par. 10).

Petitioner moved to strike the answer and the amendment to the answer pursuant to Equity Rule 33 on the ground that said answers were clearly insufficient in point of law (R. 22), which motion was denied (R. 23).

On three occasions during the period from December 14th to December 29, 1933, on orders entered by the court (R. 64, 65) the receivers paid petitioner $186,162.48 (R. 44, 45, Par. 16, 17, 19) collected on accounts assigned to petitioner and petitioner collected $83,538.30 on trade acceptances purchased from the company (R. 45, Par. 18) which paid all cash advances by petitioner to the company, together with compensation or interest at the contract rate to the date the receivers were appointed (R. 45, Par. 20).

The suit proceeded for compensation at the contract rate from November 24th to December 29, 1933, amounting to $4,394.48 (R. 45) the rate of return to petitioner being variable under the terms of the contract for the reason that the compensation was calculated upon the net face amount of accounts rather than on the money advanced (R. 65, Par. h). Petitioner also claimed that it was entitled to reasonable attorney's fees and costs (R. 16).

Prior to receivership, while adjustments were being made of accounts and cash so that a 50 per cent reserve was being maintained, the gross return to petitioner was 20 per cent per annum on the cash it advanced (R. 43). Subsequently, for a short period the return rose sharply, due to the retention of collections by the receivers and to the method of calculation. There is no proof in the record, pleadings, stipulations of fact, testimony or evidence indicating or inferring that the rate of return to petitioner at any time for any period amounted to 250 per cent per annum as found by the trial court in its findings of fact and conclusions of law (R. 74) and accepted as proven by the Court of Appeals (R. 95). Petitioner excepted to the findings of fact and conclusions of law made by the

trial court (R. 75). However, by the amended stipulation of facts it was agreed that the compensation claimed subsequent to receivership constitutes an average claim of 28.3 per cent upon the average net balance of cash outstanding (R. 65).

The suit was heard on the pleadings and a stipulation of facts (R. 30) and an amended stipulation of facts (R. 62) together with a small amount of testimony introduced by each side (R. 23 to 29, inc.). The District Court allowed petitioner interest from the date the receivers were appointed at the rate of 7 per cent per annum and denied further relief (R. 76) on the ground that paying 28.3 per cent interest per annum is unconscionable, adhering strictly to the decision of the Circuit Court of Appeals for the 7th Circuit in *In re: Chicago Reed & Furniture Company,* 7 Fed. (2) 885.

The Court of Appeals affirmed the decree (R. 98) likewise adhering to the *Reed* case (R. 97).

After the appeal was perfected and briefs filed and on the day the matter was set for oral argument, an order was entered by the Court of Appeals, substituting Frank M. McKey as trustee in bankruptcy of the company, in lieu of said equity receivers (R. 92).

Specifications of Error.

The Courts below erred:

1. The District Court erred in failing to allow petitioner's motion to strike the answer and amendment to the answer from the files.

2. The District Court erred in refusing to grant the prayer of the intervening petition.

3. In not holding that Federal courts are obliged to follow State laws permitting corporations to pay any rate of interest.

4. The Circuit Court of Appeals erred in affirming the decree of the District Court.

5. The Courts below erred in not overruling *In re: Chicago Reed & Furniture Company,* 7 Fed. (2) 885 (7th Circuit).

QUESTIONS PRESENTED.

I.

Where a state, by statute, authorizes corporations to pay any rate of interest that such corporation may determine, does a Federal court located within that state have to enforce a contract of such corporation to pay 28.3 per cent interest, or is such contract, prima facie, without claim or proof of fraud, accident or mistake, so manifestly harsh and oppressive that the court may refuse relief solely on that ground?

II.

Are receivers appointed by a Federal equity court bound by the terms of a contract under which the corporation that they are appointed for agrees to pay interest at the rate of 28.3 per cent as well as reasonable attorney's fees and costs?

III.

Should the District Court sustain a motion to strike answers when such answers are clearly unfounded in law?

IV.

Are the statutes of a state permitting corporations to pay ANY rate of interest binding on Federal equity courts sitting within that state?

SUMMARY OF ARGUMENT.

The statutes of Illinois permit corporations to pay any rate of interest that they may agree upon and these statutes have been upheld by the Supreme Court of Illinois. (pp. 10, 11.)

The 7th Circuit held in *In re: Chicago Reed & Furniture Company,* 7 Fed. (2d) 885 (1925) and again in the instant decision that Federal courts in equity proceedings are not obliged to enforce the agreement of a corporation to pay 28.3 per cent as interest, on the sole ground that such rate is manifestly harsh and shocking to the conscience, which holding is contrary to the weight of authority. (p. 11.)

The policy of a state is determined by its legislative enactments and the decisions of the court of last resort, which enactments and determinations are binding and conclusive on Federal courts sitting within that state. (p. 14.)

Contracts, fairly entered into between competent parties, without any question or evidence of fraud in the case are binding and enforceable in the courts, and corporations who are precluded by state law from defending on the ground of usury, cannot do so merely because the matter is pending in the Federal courts. (pp. 17, 18, 19.)

Petitioner in this case was not asking for equitable relief. It was merely seeking to avail itself of a substantive right under the statutory law of the state. (p. 20.)

In the absence of fraud, accident or mistake, a court of equity should not change the terms of a contract. (p. 21.)

Legislative enactments permitting corporations to pay any rate of interest they may agree upon have been upheld by reviewing courts in many states. (pp. 22, 23.)

Receivers appointed by a court of equity to operate the business of a corporation are bound by the terms of a contract under which the corporation agrees to pay interest, costs and attorney's fees. (pp. 23, 24, 25.)

Petitioner was entitled to recover its costs and attorney's fees under the terms of the contract. (pp. 26, 27, 28, 29.)

ARGUMENT.

I.

The policy of the Illinois law as reflected by its statutes and the decisions of its reviewing Courts is to permit corporations to pay any rate of interest.

(A) The statutes as construed by the Supreme Court of Illinois are binding on Federal equity courts sitting within that state.

As appears from the statement of facts, the vital questions presented to the District Court and to the Circuit Court of Appeals was whether an Illinois corporation may stipulate or agree upon any rate of compensation or interest and take and pay the same, and whether such contract is binding upon receivers for the corporation appointed by a Federal equity court.

Petitioner filed an intervening petition setting forth the contract, the obligations of the company thereunder, various breaches thereof by the company, and concluded with a prayer for an order directing the receivers to deliver all moneys collected by them on accounts sold to petitioner until such time as the petitioner shall have received the amount due it, together with its reasonable attorney's fees, costs and expenses (R. 16). The answer and the amendment to the answer filed by the receivers set forth no legal defense to the petition and the motion to strike the same should not have been denied (R. 17, 21, 22).

By the statutes of Illinois in effect during the time of all the transactions here involved it was provided that a corporation may "borrow money for its corporate purposes

at such rates of interest as the corporation may determine without regard to the restrictions of any usury law of this state." (Cahill's Illinois Revised Statutes, 1933 Ed. Ch. 32, Sec. 5(h) page 725.) This statute is almost identical with the enactment of 1919. From 1919 to 1925 there were no decisions either in the State courts or in the Federal courts located in Illinois construing the above statute. In 1925 the Circuit Court of Appeals for the 7th Circuit decided *In re: Chicago Reed & Furniture Company,* 7 Fed. (2nd) 885. That case involved a loan of $1,700 on chattel mortgage security. Notes aggregating $2,000 payable in twelve monthly installments and bearing interest at 7 per cent were given. The borrower was adjudicated bankrupt and on a petition filed by the holder of the security, relief was granted, except as to the item of $300 claimed to be a commission, the court holding that notwithstanding the Illinois statutes permitting corporations to pay any rate of interest, such statute did not abrogate the rule that courts of equity will not lend their aid to enforce contracts which upon their face are so manifestly harsh and oppressive as to shock the conscience.

Since July 1, 1925, the Interest Acts of Illinois have provided:

> "With respect to money loaned to or in any manner due and owing from a corporation, the parties may stipulate or agree upon any rate of interest whatsoever, and take and pay the same." (Cahill's Illinois Rev. Statutes, 1933 Ed. Ch. 74, Sec. 4, page 1701.)

On February 24, 1928, in *Tennant* v. *Joerns,* 329 Ill. 34, the Supreme Court sustained the constitutionality of the 1919 Act permitting corporations to borrow money at such rates of interest as they may determine and in effect held that said statute withdrew from the operation of the Interest Act loans to corporations which would otherwise be unlawful. Subsequently, the Appellate Court of Illinois in *Simon* v. *South End Cleaners & Dyers, Inc.,* 246 Ill.

App. 14 and *Polish Peoples Home Association and Printpress Company* v. *Atlas, et al.,* 246 Ill. App. 457, the latter an equity case, held that by reason of the statute, corporations could not defend on the ground of usury.

On March 5, 1934, the Circuit Court of Appeals for the 8th Circuit rendered its decision in *Merchants & Manufacturers Securities Co.* v. *Johnson,* 69 Fed. (2d) 940.* In that case identical contracts were before the court. A high rate of interest was involved. The defenses urged by the receiver were usury and that the contracts were harsh, inequitable and unconscionable. The finance company contended that the contracts were to be construed according to the laws of Illinois where usury was no defense. The receiver argued to the contrary and relied on the *Chicago Reed & Furniture* case, 7 Fed. (2) 885 as the authority in the 7th Circuit. Ignoring that decision the court held that the contracts construed by the laws of Illinois were not usurious and that the receiver succeeded to the property, subject to the same contract rights as obtained at the time of his appointment, and reversed the District Court.

In 1927 the Circuit Court of Appeals for the 2nd Circuit decided the case of *In re: International Raw Material Corporation,* 22 Fed. (2) 920. In that case there was a pledge of accounts by the bankrupt. The finance company sold the collateral and there remained a surplus of $3,351.42, out of which amount the finance company retained interest of $1,251.75, calculated at the rate of 1½ per cent per month, and $500.00 in attorney's fees. The referee followed the holding in *In re: Chicago Reed & Furniture Company,* 7 Fed. (2) 885 and directed the finance company to pay over to the trustee the amount it withheld for interest and attorney's fees, which decision was affirmed by the District Court. On appeal, that

*Certiorari denied October 8, 1934.

decision was reversed and the Court of Appeals held that there was no justification for nullifying the agreement of the parties because the interest and commissions which they deliberately arranged were too large to satisfy the ideas of the court, and that the statute has not attempted to control usurious contracts of corporations. The *Chicago Reed & Furniture Company* case is mentioned by name and severely criticised.

The Court of Appeals in this case recognize the force and logic of the argument advanced by the 2nd Circuit in the *International Raw Material Corporation* case, 22 Fed. (2) 920, but refuse to follow it. The court concedes that the International case is similar, differing only in the amount of attorney's fees claimed and in the fact that petitioner was *attempting* to charge the receivers a rate of interest considerably higher than the rate in fact used between the contracting parties, and conclude their opinion with this statement:

> "We can see no reason under the circumstances of this case for overruling the principle laid down in the Chicago Reed & Furniture case, *supra*, in favor of that enunciated in International Raw Material Corporation, *supra*." (R. 97.) (Opinion p. 473.)

The Court of Appeals in its opinion in the instant case relies on its former decision in the *Chicago Reed & Furniture Company* case, 7 Fed. (2d) 885, as the sole authority for the proposition that equity will not enforce a contract which is unconscionable, only because the interest provided for is higher than the court thinks proper, and on that point the Court of Appeals admits that the weight of authority is with the petitioner when it says that petitioner finds substantial support for its contention to the contrary in cases cited by it, the strongest of which for its purposes is *International Raw Material Corporation*, 22 Fed. (2) 920.

The policy of the Illinois law was established by the legislature when it adopted statutes permitting corporations to pay any rate of interest and such policy is clearly expressed in *Tennant* v. *Joerns,* 329 Ill. 34, wherein it was urged that the act authorizing corporations to pay any rate of interest is immoral in principle and contrary to public policy. With respect to that phase of the matter the court said, page 40:

> "What constitutes usury is determined by the legislature and varies in different States. It has varied at different times in this State. This court held in *People* v. *Wheeler,* 259 Ill. 99, that usury of itself is not immoral. 'It would be contrary to common experience to say that a man who lends money at usurious rates is for that reason, alone, not a man of good moral character.' Usury is not a crime in itself, and its defense to a suit depends upon the expressed statutes. It is not founded on a common law right and is clearly within the power of the legislature to take it away. (*Rosa* v. *Butterfield,* 33 N. Y. 665; *Southern Life Ins. and Trust Co.* v. *Packer & Prentice,* 17 *id.* 51; *Town of Danville* v. *Pace,* 25 Gratt. i, 18 Am. Rep. 663.)"

It is respectfully submitted that under the Illinois law, corporations may engage themselves to pay any rate of interest and such obligation is binding and enforceable in the courts.

(A) The statutes as construed by the Supreme Court of Illinois are binding on Federal equity courts sitting within that state.

This court has repeatedly held that the statutes of a state are binding upon Federal courts sitting within the state, provided such statutes do not enlarge or diminish Federal equity jurisdiction.

In *M. K. & T. Trust Company* v. *Krumseig,* 172 U. S. 351, this court considered the question of whether the statutes of a state defining the rights of the parties under a contract for a high rate of interest was binding on Federal equity courts. The holding is that all questions of the rights of the parties under such contracts depend upon the laws of the state where the transaction took place and that Federal courts are bound by statutes and decisions of the courts of such state on that subject, even though such statutes and decisions appear contrary to fundamental principles of equity, and said, at page 355:

> "Usury is, of course, merely a statutory offence, and Federal courts in dealing with such a question must look to the laws of the State where the transaction took place, and follow the construction put upon such laws by the state courts. *DeWolf* v. *Johnson,* 10 Wheat. 367; *Scudder* v. *Union National Bank,* 91 U. S. 406."

And again, page 359, says:

> "If the states, whether New York, Arkansas, Minnesota or others, think that the evils of usury are best prevented by making usurious contracts void, and by giving a right to the borrowers to have such contracts unconditionally nullified and cancelled by the courts, such a view of public policy, in respect to contracts made within the State and sought to be enforced therein, is obligatory on the Federal courts, whether acting in equity or at law. The local law, consisting of the applicable statutes as construed by the Supreme Court of the State, furnishes the rule of decision."

In *Michigan* v. *Michigan Trust Co., Receiver,* 286 U. S. 334, in an equity proceeding, this court said, page 342:

> "Our task is to ascertain the meaning of a Michigan statute, and as to that the courts of the State, if they have spoken, pronounce the final word."

In *Mason, et al.* v. *United States,* 260 U. S. 545, this court said, page 557, *et seq.*:

> "Subject to certain exceptions, the statutes of a State are binding upon the federal courts sitting within the State, as they are upon the state courts. One of the exceptions is that these statutes may not be permitted to enlarge or diminish the federal equity jurisdiction. *Mississippi Mills* v. *Cohen,* 150 U. S. 202. That jurisdiction is conferred by the Constitution and the laws of the United States and must be the same in all the States. *Neves* v. *Scott,* 13 How. 268. But while the power of the courts of the United States to entertain suits in equity and to decide them cannot be abridged by state legislation, the rights involved therein may be the proper subject of such legislation. See *Missouri, Kansas & Texas Trust Co.* v. *Krumseig,* 172 U. S. 351, 358. In *Brine* v. *Insurance Co.,* 96 U. S. 627, 639, this Court said: 'We are not insensible to the fact that the industry of counsel has been rewarded by finding cases even in this court in which the proposition that the rules of practice of the Federal courts in suits in equity cannot be controlled by the laws of the States, is expressed in terms so emphatic and so general as to seem to justify the inference here urged upon us. But we do not find that it has been decided in any case that this principle has been carried so far as to deny to a party in those courts substantial rights conferred by the statute of a State, or to add to or take away from a contract that which is made a part of it by the law of the State, except where the law impairs the obligation of a contract previously made."

It follows that the District Court and the court below are bound by the Illinois statutes and the decisions of the local courts, which they refused to follow.

II.

The finding by the Court below that courts of equity need not enforce contracts of corporations to pay a large amount of compensation or interest on the ground that such rate is shocking to the conscience of the Chancellor, is contrary to the weight of authority, and overlooks the maxim that equity follows the law.

The opinion of the court below assumes that there is some equitable or moral standard by which rates of compensation or interest may be measured in a Federal court of equity, without reference to the statutes of the individual state, and that a court of equity may properly decline to enforce a contract, free from fraud, for an agreed rate, merely because such rate is too high in the opinion of the court, and disregard the statutes of the State where the transaction took place, which expressly permits *any* rate upon which the parties may agree.

In the *Reed* case, the court cites 39 Cyc. 891 as authority for its conclusion that equity will not enforce a contract where the rate of interest to be paid by a corporation which cannot legally defend on the ground of usury is so harsh and oppressive as to shock the conscience. That section is now found in 66 C. J. 143 under the title *"Oppressive Contracts as Distinguished From Usurious Contracts."* There are several cases cited under this heading, but none of them grant relief to a corporation. One of the cases cited, *Hagaman* v. *Reinach,* 96 N. Y. S. 719 (1905) quotes the opinion of this court in *Lloyd* v. *Scott,* 7 L. Ed. 833 (4 Peters, 205, at page 222):

> "The act of usury has long since lost that deep moral stain which was formerly attached to it; and is now generally considered only as an illegal or immoral act because it is prohibited by law."

To sustain the view of the court below, it necessarily had to ignore the contract, freely and voluntarily entered into between the parties. There is nothing in the Illinois law fixing 7 per cent interest as either a minimum or a maximum rate to be paid by a corporation, and that, we submit, is a material change of the terms of the contract not contemplated by either of the parties.

In *Pacific State Savings, Loan & Bldg. Co.* v. *Green, et al.,* 123 Fed. 43 (9th Cir.), the court says, page 46:

> "The general rule is, we think, well settled that a court of equity is not authorized to set aside and annul a contract made by parties with full knowledge of all the terms and conditions of the same, without it is clearly and satisfactorily shown that there was fraud, oppression, or undue advantage taken with reference to its execution." (Citing cases.)

To the same effect see *Gunby* v. *Armstrong,* 133 Fed. 417 (5th Cir.), and cases cited therein at page 433.

In *Poe* v. *Ulrey,* 233 Ill. 56, at page 63, the Supreme Court say:

> "So far as the charge that the contract was harsh and unjust is concerned, it may be said that the parties were competent to contract with each other, and neither side can be relieved from their agreements on the ground that they did not use good business judgment in entering into the contract. There is no question of fraud and no charge or evidence of fraud in the case, and where parties who are competent in law and in fact to enter into contracts, freely and voluntarily contract with each other, it is of the utmost importance to them, and the public as well, that their agreement shall be respected and enforced by the courts, and that neither shall be relieved from the obligation of his contract except upon some certain ground deemed valid by the law."

Contracts identical with the one in evidence where compensation is calculated by the same method have been con-

strued by Federal trial and Appellate Courts and in each instance where the defendant corporation was precluded from interposing the defense of usury these contracts were enforced in equity and bankruptcy proceedings, not only against the corporation, but against receivers as well.*

The question of whether or not this contract was unconscionable is inseparably connected with the substantive law and public policy of the State of Illinois. Usury has never been considered *malum in se,* but *malum prohibitum.*

In *People* v. *Wheeler,* 259 Ill. 99, the Chicago Bar Association sought to disbar a practicing attorney on the ground that he was lending money at rates of interest varying from 2½ to 10 per cent a month. The Association urged his disbarment on the theory that exacting usury was immoral and hence the respondent was not a person of good moral character, which is one of the requirements for admission to the Bar. In dismissing the information the Supreme Court said:

> "Usury is not an offense against the law in Illinois. Of itself it is not immoral. It would be contrary to common experience to say that a man who lends money at usurious rates is for that reason, alone, not a man of good moral character."

Nowhere in the record or pleadings is it claimed that petitioner came into court with unclean hands, as found by the learned trial court in its memoranda opinion (R. 70). No charge is made by the receivers of any fraud, deceit,

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* Estes v. E. B. Estes & Son, 24 Fed. (2nd) 756 (Mass. Dist. Ct.); International Raw Material Co., 22 Fed. (2nd) 920 (2nd Cir.); Ramsey v. Marlin Firearms Co., 14 Fed. (2nd) 314 (Conn. Dist. Ct.); In re: Rosenblatt, 299 Fed. 771 (Dist. Ct. of New York); Boise v. Talcott, 264 Fed. 61 (C. C. A. 2nd); In re: Gotham Can Co., 48 Fed. (2nd) 540 (C. C. A. 2nd); In the matter of Lutz & Schramm Co., Inc., 38 A.B. R. 351 (Dist. Ct. Pa.); Brierly v. Commercial Credit Co., 43 Fed. (2nd) 730 (C. C. A. 3rd); Chapman v. Emerson, 8 Fed. (2nd) 353 (C. C. A. 4th); United Divers v. Commercial Credit Co., 289 Fed. 316 (C. C. A. 5th); LeSueur v. Manufacturers Finance Co., 285 Fed. 490 (C. C. A. 6th); Merchants & Manufacturers Securities Co. v. Johnson, 69 Fed. (2nd) 940 (C. C. A. 8th); Pacific State Savings Loan & Bldg. Co. v. Green, 123 Fed. 43 (C. C. A. 9th).

dishonesty, mistake or any act on the part of petitioner justifying that conclusion.

It is true that the parties to this suit are in a court of equity, but petitioner was not asking for equitable relief—it was merely asserting its legal rights. It was not in a court of equity by choice but was forced into said proceedings by reason of the appointment of receivers who were collecting and retaining petitioner's money and by reason of the injunction entered by the trial court restraining all persons from interfering with the receivers and the estate (R. 9).

Exactly the same situation obtained in *M. K. & T. Trust Company* v. *Krumseig*, 172 U. S. 351, wherein this court held, at page 358:

> "But it is strenuously argued, and of that opinion was Circuit Judge Sanborn in the present case, that Federal courts, in the exercise of their equity jurisdiction, do not receive any modification from the legislation of the States or the practice of their courts having similar powers, and that consequently no act of the legislature of Minnesota could deprive the Federal courts sitting in equity of the power or relieve them of the duty to enforce and apply the established principle of equity jurisprudence to this case that he who seeks equity must do equity, and to require the appellees to pay to the appellant what they justly owe for principal and lawful interest as a condition of granting the relief they ask.
>
> "We think it a satisfactory reply to such a proposition that the complainants in the present case were not seeking equity, but to avail themselves of a substantive right under the statutory law of the State."

It is inconceivable that a litigant should be deprived of substantive legal rights simply because the enforcement of such rights rests with a court of equity rather than a court of law.

In *Magniac* v. *Thompson,* 15 (How.) U. S. 281, the court held:

> "Wherever the rights or the situation of the parties are clearly defined and established by law, equity has no power to change or unsettle those rights or that situation, but in all such instances, the maxim 'equity follows the law' is strictly applicable."

In *Anderson* v. *Anderson,* 2 Call (6 Va.) 198, it is said (p. 205):

> "A court of equity must consult the intention of the legislature as well as courts of law; and when the legislature have determined a matter with its circumstances, a court of equity cannot intermeddle or relieve against the express provisions of the statute."

In *Hedges* v. *Dixon County,* 150 U. S. 182, this Court said (p. 189):

> "It is too well settled to need a citation of authorities that a court of equity in the absence of fraud, accident or mistake, cannot change the terms of a contract."

In *Colonial Trust Co.* v. *Central Trust Co.,* 243 Pa. 268, it is said:

> "Legal rights are as safe in chancery as they are in a court of law and however strong an appeal may be to the conscience of a chancellor for equitable relief, he is powerless to grant it if the one from whom it must come will be deprived of a legal right."

The legislature of Illinois, which unquestionably possesses the power, has given a substantive right to corporations to pay and receive any rate of interest they see fit, and it is respectfully submitted that courts should not destroy this valuable right merely because a particular contract may, in the judgment of the court, on the surface, seem to be improvident.

Many states have adopted statutes permitting corporations to pay any rate of interest or forbidding them to interpose usury as a defense, and reviewing courts have invariably upheld and enforced these statutes in equity cases as well as in suits at law.

In **New York** the statute has been in effect since 1850 and it was there held that the effect of the statute was to repeal all existing statutes as to usury. (*MacQuoid* v. *Queens Estates,* 143 App. Div. (N. Y. S.) 134, 136.)

A similar statute in **New Jersey** was upheld in an equity proceeding. (*Ovsiovitch* v. *Federal Tool & Mfg. Co.,* 94 New Jersey Eq., 744, and in *Lembeck* v. *Jarvis Terminal Cold Storage Co.,* 64 Atl. 126.)

In **Ohio,** by statute, corporations are likewise prevented from claiming usury. (Sec. 8705 of General Code; 109 Ohio Laws, 231) and in *Alston* v. *American Mortgage Co.,* 116 Ohio 643, the Supreme Court holds that by virtue of the statute, corporations may contract for any rate of interest without limit.

By statute in **Michigan,** corporations are precluded from interposing the defense of usury to any cause of action. (Act 335, Public Acts 1927, Pt. 2, Ch. 1, Sec. 1) and in *Miller* v. *Reid,* 243 Mich. 694, in an equity action sustained the statute, and again in *Thomas* v. *Union Trust Co.,* 251 Mich. 279.

The **Virginia** law is the same and the ruling of the highest court in that state is found in *Danville* v. *Pace,* 25 Gratt. Va. 1.

In **Maryland,** the statute is approved in *Carozza* v. *Federal Finance & Cr. Co.,* 149 Md. 223. There the court differentiates between the borrowing by an individual for personal necessities, and holds that the legislature alone can determine the public policy of the state, and when it does so, through its enactments, the courts must follow

that conclusion. The *Carozza* case was quoted and approved by the Supreme Court of Michigan in *Thomas* v. *Union Trust Co.*, 251 Mich. 279.

In Illinois a statute was adopted in 1852 which declared that no corporation shall interpose the defense of usury in any action and that statute was enforced in *Hartford Ins. Co.* v. *Hadden,* 28 Ill. 260, and again in *American Central Railroad Company* v. *Miles,* 52 Ill. 174. From time to time thereafter changes were made and finally in 1919 the Corporation Act was amended permitting corporations to borrow money at such rates of interest as they may determine, and in 1925 the Interest Act was amended, permitting corporations to stipulate or agree upon any rate of interest whatsoever.

The theory expounded by the Court of Appeals in holding that merely because this contract provided for a high rate of interest makes it unconscionable, we submit, is without foundation in law or in logic. The court in its opinion points out that if this matter arose in an action at law between the original parties, it may well be that the court could not refuse to enforce the contract according to its terms (R. 97). We contend that merely because petitioner is in a court of equity, not through its own choosing, and not seeking equitable relief, and only asserting its legal rights, does not change the complexion of the law.

II-A.

These receivers appointed to continue the business of the company are bound by the terms of the contract to pay compensation and attorney's fees.

From the inception of this transaction the company was an Illinois corporation with assets of over $13,000,000 in excess of all liabilities (R. 3, 65). Acting through its

Board of Directors, and by proper resolution (R. 66) it entered into the contract in evidence under which it employed petitioner to perform various and sundry services for it. One of the major things apparently was to advance large sums of money from time to time. To secure the payment for such services and the compensation that was to be earned by petitioner, the company assigned certain of its accounts receivable and trade acceptances. Rather than to stipulate for definite compensation for these services and the advances, the parties agreed that compensation was to be determined by the amount of accounts assigned, the contract in this respect providing that for all services rendered and other considerations set forth in the contract, the company was to pay petitioner an amount equal to 83½ per cent of 1/30 of 1 per cent of the net face amount of accounts, for each day from the date of purchase by, until paid to, petitioner. Whether all that the parties actually contemplated by this contract was merely to advance the money does not appear from the pleadings, nor from the evidence. In the cases cited by the Court of Appeals in its decision the contracts did not specify that any services were to be rendered and there was proof of a contrary intention. Furthermore, those cases are inapplicable because at the time they were decided the laws of the state where the contract was made did not preclude corporations from interposing the defense of usury.* The intervening petitioner alleged that it had fully performed everything that was required to be performed by it under the terms of the contract (R. 13) and in neither the answer nor the amendment to the answer do the receivers challenge this fact (R. 17, 21). The

* Home Bond Company v. McChesney, 239 U. S. 568; National Discount Company v. Evans, 272 Fed. 570; LeSueur v. Manufacturers Finance Company, 285 Fed. 490; Chase and Baker Company v. National Trust and Credit Company, 215 Fed. 633; In re: Gotham Can Company, 48 F. (2d) 540. (The citation in re: Grand Union Company, 210 Fed. 353, is erroneous).

appointment of receivers in equity to operate a business cannot, and does not, change executed contract in any respect. Executed contracts by corporations who are precluded by statute from interposing the defense of usury are as binding upon the receivers as they are upon the companies themselves.

In *Estes* v. *E. B. Estes & Sons,* 24 Fed. (2) 756, a similar contract was under consideration and the court held that the receiver is bound even though the contract should be deemed to be of little or no advantage to the company.

In *Ramsey* v. *Marlin Firearms Corporation,* 14 Fed. (2d) 314, the court held that the appointment of the receivers did not divest the finance company of its title to the accounts and the collections by the receivers were for the benefit of the finance company.

In *International Raw Material Corporation,* 22 Fed. (2d) 920, at page 923, it was said:

> "Neither the corporations, nor those who may succeed to their rights, nor their sureties, are heard to object to their bargain, either at law or in equity, because of usury. *Curtis* v. *Leavitt,* 15 N. Y. 9; *Stewart* v. *Bramhall,* 74 N. Y. 85; *Gamble* v. *Queens County Water Co.,* 123 N. Y. 108, 25 N. E. 201, 9 L. R. A. 527; *Hubbard* v. *Tod,* 171 U. S. 474, 19 S. Ct. 14, 43 L. Ed. 246; The Vigilancia (C. C. A.), 73 F. 452."

In *Merchants & Manufacturers Securities Co.* v. *Johnson,* 69 Fed. (2nd) 940, the court said, page 945:

> "The receiver was appointed, not to wind up the affairs of the Oil and Petroleum Companies, but to carry on their business as going concerns. He succeeds to the property of the companies subject to the same liens, limitations, restrictions, or contract rights as obtained at the time of his appointment. He has no greater or different rights than those that might have been asserted by the companies. *Fosdick* v. *Schall,* 99 U. S. 235; *In re*: Gotham Can Co., (C. C. A.

2) 48 Fed. (2d) 540; *Ramsey* v. *Marlin Firearms Corp.*, (D. C.) 14 Fed. (2d) 314; *Estes* v. *E. B. Estes & Sons*, (D. C. 24 Fed. (2d) 756.)"

III.

Petitioner was entitled to deduct from collections on pledged accounts reasonable attorney's fees and costs expended in the prosecution of its intervening petition.

Petitioner sought to recover reasonable attorney's fees pursuant to the terms of the contract. When the petition was filed there was an indebtedness owing on the contract in excess of $250,000. The receivers were making collections and refused to turn over such collections to petitioner until directed to do so by the court (R. 43, Par. 13) thereby making it imperative for petitioner to engage counsel. The receivers immediately upon being appointed procured an order of the trial court *without notice to petitioner* authorizing the receivers to turn over to petitioner funds collected by the receivers on assigned accounts *on the same basis as prior to the filing of the bill of complaint,* which order was construed by petitioner to mean that it would be required to return to the receivers one-half of the collections received on assigned accounts. Petitioner contended, and rightfully so, that it could retain all of the collections until payment in full of its indebtedness was made. The contract authorizes this action in the event that the company or any of the accounts are in default (R. 47, 49), and many such defaults existed (R. 64) and the appointment of the receivers constituted an additional default under such contract (R. 48, Par. fifth, Sec. 2). Aside from the strict construction of the contract the record discloses that the accounts petitioner held were merely claims against dealers and distributors of the company for merchandise sold. At the time the intervening petition was filed it was very

doubtful whether the full amount owing to petitioner would be paid. The receivers were evidently in doubt about this matter, because the court entered an order on their petition (R. 61) authorizing the expenditure of $35,000 for "further advertising" for the month of December, 1933, and such $35,000 was paid to the distributors in the form of credits on their accounts for the purpose of inducing them to continue in the fold of Grigsby-Grunow (R. 25). The chief auditor for the receivers testified:

> "There was a price concession on one particular line of a substantial amount. In fact, in my opinion there was practically everything being done, a combination of items, to thaw out the accounts. There were price concessions. We took back merchandise and we put through special allowances. It was necessary to get some money and so we strove to get them." (R. 24.)

Conferences were then held between counsel for petitioner and the receivers in an effort to amicably adjust the matter, without avail (R. 63, 64). With this uncertainty present, petitioner was unwilling to return to the receivers 50 per cent of moneys collected on such accounts receivable and if they were required to obey and follow the order (R. 63) their position might have been seriously endangered. Obviously, in these circumstances, it became necessary for petitioner to engage counsel to protect its interests. The record discloses numerous conferences between counsel for petitioner and the receivers at which various propositions of settlement were offered (R. 63, 64). The intervening petition had to be prepared and filed; appearances, according to the record, were made in court by counsel for petitioner on November 29 (R. 17), December 5 (R. 19), December 14 (R. 65), December 21 (R. 69), December 22 (R. 65, 67), and January 31, 1934 (R. 23, 75). On behalf of petitioner one witness testified that its counsel expended sixteen days' time on this matter in conferences with the receivers, preparing the intervening petition, examining the answers filed by the receivers, in-

vestigating the authorities, preparing the stipulation of facts and the amended stipulation of facts, and preparation of the trial brief (R. 26). An attorney called as an expert testified that in his opinion a reasonable attorney's fee would be $7,800 (R. 29) and no evidence was offered to the contrary.

Petitioner, throughout, has requested a REASONABLE fee and never insisted upon the allowance of $7,800. Notwithstanding such testimony the trial court in its findings of fact (R. 73) and conclusions of law finds that:

> "No evidence was introduced as to the amount of reasonable attorney's fees, if any, for counsel for intervening petitioner, for services necessarily rendered herein." (R. 75.)

In its memoranda opinion, the trial court said:

> "Perhaps the court should say further, concerning the claim for attorney's fees, that the court cannot see any reason for the intervening petitioner having obligated itself for attorney's fees in any considerable amount." (R. 72.)

And in the decree, interest is allowed at the rate of 7 per cent per annum and all further relief prayed for in the intervening petition was denied (R. 76).

The Court of Appeals draws its own conclusion that the attorney's fees amounted to 177 per cent of the maximum amount claimed against the receivers (R. 97) which in view of the foregoing, we submit is without merit.

In numerous cases under similar contracts, courts have allowed attorney's fees in equity and bankruptcy cases.*

In *Boise* v. *Talcott,* 264 Fed. 61, the court says:

> "The items allowed in payment of attorneys' fees and disbursements are fully covered by the contract which provides for payment of 'all legal expenses and reasonable counsel fees.'"

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* In re: International Raw Material Company, 22 Fed. (2nd) 920; Boise v. Talcott, 264 Fed. 61; Estes v. E. B. Estes & Son, 24 Fed. (2nd) 756; Matter of Lutz & Schramm Company, Inc., 38 A. B. R. 351; In re: Gotham Can Company, 48 Fed. (2nd) 540; In re: Rosenblatt, 299 Fed. 771.

In the case of *In re: International Raw Material Company,* 22 Fed. (2nd) 920, the Circuit Court of Appeals for the Second Circuit approves the payment of attorney's fees under a provision in a contract which says (p. 922):

> "The bankers may employ counsel to advise them and charge the account of the client with attorney's fees actually incurred, or reasonable prospective attorney's fees, and the amount thereof shall be added to the lien of the bankers and be secured by the collateral."

In the matter of *Lutz & Schramm Co., Inc.,* 38 Am. Bankruptcy Reports, 351, the court says (p. 356):

> "As the contract provides for attorney's fees and the amount charged is not claimed to be out of proportion to the services rendered, I am also of opinion that this claim should be allowed."

In the very latest expression on the subject, *Merchants & Manufacturers Securities Co.* v. *Johnson,* 69 Fed. (2nd) 940 (8th Circuit) the amount sought to be recovered by the finance company was $32,479.01 and the trial court denied attorney's fees. On appeal the Circuit Court reversed that decree and allowed the fees as a general claim, and said, page 945:

> "There is no finding by the lower court fixing the amount of such attorney's fees, although there is evidence in the record as to the value of the legal services rendered. We have held that the judge of the trial or appellate court is an expert himself and knows as well as a legal expert what are reasonable attorney's fees. * * * The question was not put in issue by any testimony produced by appellee (receiver) presumably on the theory that no amount should in any event be allowed, or on the theory that the court could determine the reasonableness of the attorney's fees from the record. * * * We therefore fix the fees to be recovered by appellant at $3,000.00."

CONCLUSION.

The policy of the Illinois law as shown by its legislative enactments and as interpreted by the courts of last resort of that state permits corporations to engage themselves to pay any rate of interest whatsoever. Whether this contract is for a loan of money secured by a pledge of the accounts or whether it is for services to be rendered by petitioner, which includes as an incident thereof the advance of large sums of money, is immaterial. In either event the company and the receivers appointed for the company are liable on the contract according to the terms thereof. Federal courts of equity located in Illinois are bound by such statutes. The theory advanced by the Seventh Circuit that the court is not obliged to grant relief where a contract, only because it provides for the payment of a large amount of compensation or interest is unconscionable, is utterly unfounded. This petitioner is in a court of equity, seeking to enforce a substantive right under the statutes of Illinois only because that court took possession of the assets of the company, appointed receivers and enjoined petitioner from bringing a suit elsewhere. No equitable principles are involved in this suit. Even though it may be determined that petitioner is merely a lienor with the accounts as security, it had an absolute right to make the collections on such accounts and deduct therefrom the amount of its advances, plus its costs, expenses and reasonable attorney's fees.

It is respectfully submitted that the decision of the Circuit Court of Appeals for the Seventh Judicial Circuit

should be reversed and the cause remanded to the District Court with instructions to enter a decree in favor of petitioner.

Respectfully submitted,

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